Corporate Tax Update

INTERNATIONAL

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INTERNATIONAL TAX

WHAT CHANGED UNDER TAX REFORM?

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Overall System of Taxation

- Prior system taxed U.S. citizens and residents on worldwide income.
- Tax reform shifted U.S. taxation closer to a territorial system.
  - Earnings from foreign branches of U.S. companies continue to be taxed currently.
  - Earnings of foreign corporations owned by pass-through entities are generally taxed when distributed.
  - Earnings of foreign corporations owned by C Corporations are generally exempt from tax via 100% dividends-received deduction.
  - However, see Anti-Deferral Rules.

Participation Exemption (DRD)

- 100% dividends-received deduction allowed against dividends received from 10%-owned foreign corporation.
- DRD is the vehicle that delivers the new limited territorial system.
- Exemption is only allowed to C Corporations.
- Applies to dividends after December 31, 2017.

Transition Tax

- One-time "transition tax” on the deemed repatriation of accumulated earnings held offshore.
- Accumulated earnings measured at the greater of balances at November 2, 2017 and December 31, 2017.
- 15.5% tax rate to the extent of foreign liquid assets.
- 8% tax rate on remaining balance of earnings.

Anti-Deferral Rules

- Anti-Deferral provisions cause certain categories of foreign corporation income to be taxed currently.
- Subpart F Income.
- Investment in U.S. Property (956).
- Passive Foreign Investment Company (PFIC).
- Global Intangible Low-Taxed Income (GILTI) – New.

GILTI

- Global Intangible Low-Taxed Income.
- Not limited to intangible income.
- Income earned by a controlled foreign corporation (CFC) above a 10% return on its depreciable tangible property used to generate the income.
- 50% deduction against GILTI allowed for C Corps only generally reduces tax rate to 10.5%.
- Deduction not allowed for pass-throughs – tax rate on GILTI may be as high as 37%.

Foreign Tax Credit

- Direct credit allowed for foreign tax paid by U.S. entity or foreign branch.
- Indirect credit for taxes deemed paid on income distributed as dividends – REPEALED.
- Indirect credit for taxes deemed paid on Subpart F income – available only to C Corporations.
- Foreign Tax Credit "Baskets":
  - General
  - Passive
  - GILTI – new
  - Foreign Branch – new

Foreign-Derived Intangible Income

- Informally known as “FDII.”
- Deduction to incentivize export of sales and services.
- Income eligible for deduction is profit above a 10% return on depreciable tangible property used to generate the income.
- May reduce tax rate on eligible income to as low as 13.125% thru 2025 (16.406% thereafter).
- Limited by taxable income.
- Available only to C Corporations.

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BEAT

- Base Erosion and Anti-Abuse Tax.
- 10% minimum tax on taxable income modified to exclude “base-eroding payments.”
- Base-eroding payments are otherwise deductible payments made to a foreign related party.
- Tax only applies to C Corporations with average annual gross receipts of $500 million or more, and a “base-erosion percentage” of 3% or more.
- Applies to tax years beginning after 12/31/2017.

BEPS

- Base-Erosion and Profit Shifting.
- Initiative of the Organization for Economic Cooperation and Development.
- Adopted by most industrialized nations, including U.S.
- BEPS Action 13 requires Country-by-Country Report, Local File, Master File.
- Reports income, assets, employees, taxes, etc. by jurisdiction.
- Applicable to multinational groups with consolidated revenues in excess of €750 million.

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WHAT SHOULD I LOOK FOR?

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Awareness is the Key

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Taxpayer Types Impacted

- Individuals
- Partnerships
- S Corporations
- C Corporations
- Trusts
- Estates
- Not-for-Profits

Common Issues

- Foreign Financial Account Reporting
- Foreign Entity Reporting
- Foreign Transaction Reporting
- U.S. Withholding Tax
- Transfer Pricing
- Foreign Tax Credits
- Approach to Planning

Foreign Bank Account Reporting

- FinCEN 114 (“FBAR”)
  - $10,000 reporting threshold is for the total of all financial account balances, rather than per account.
  - Calendar year report, translated at Dec 31 rate.
- Foreign Account Tax Compliance Act (“FATCA”)
  - Form 8938.
  - Both individuals and domestic entities may have filing requirement.
  - Higher reporting thresholds than FBAR, thresholds vary based on residency and marital status.
  - Includes ownership interests in foreign entities.
- Includes all financial accounts, not just bank accounts

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Foreign Entity Reporting

- Controlled Foreign Corporation (Form 5471)
  - Consider Category 2 filing for officers and directors.
- Passive Foreign Investment Company (Form 8961)
  - 75% of gross income is passive, or
  - 50% assets held to generate passive income.
  - Very punitive tax results if applicable.
  - Includes many foreign investment accounts.
- Foreign Partnership (Form 8865)
- Foreign Disregarded Entity (Form 8858)
- Foreign Trust (Form 3520-A)
  - Can include foreign retirement accounts.

Foreign Transaction Reporting

- Transfer of Property to Foreign Corp. (Form 926)
  - Actual transfers of property or cash.
  - Formation of a new foreign corporation, restructuring.
- Transactions with Foreign Trusts (Form 3520)
  - Remember foreign retirement accounts.
- Foreign-Owned U.S. Corporation (Form 5472)
  - Sales, services, royalties, interest, management fees, etc.
  - Form for each related entity with transactions.
- International Boycott Report (Form 5713)
  - Review apportionment detail, request by country.

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U.S. Withholding Tax

- Most payments from the U.S. to a foreign person or entity will be subject to withholding tax and reporting.
- Fixed, Determinable, Annual, Periodical Income (FDAP)
  - Includes interest, dividends, rents, royalties, premiums, annuities and certain wages.
  - 30% withholding tax on gross income.
  - Withholding rate may be reduced by treaty.
- Effectively Connected Income (ECI)
  - Income from a U.S. trade or business.
  - Generally exempt from withholding tax.
  - 37% or 21% Withholding Tax required on foreign partners in a partnership that has ECI.

U.S. Withholding Tax

Relevant Tax Forms:

- W-8 Series
  - Establishes tax status of the payee.
  - Should always be requested before making payment to foreign person.
- 1042 Series - Withholding Tax on FDAP
  - Due March 15.
  - Form required to be filed regardless of tax exemption, including exemption for ECI.
- 8804, 8805, 8813 – Withholding on Partnership ECI
  - Due 15th day of 3rd month after partnerships year end.
  - 8813 filed quarterly.

Transfer Pricing

- Pricing between controlled (related) entities.
- Transactions should be priced at arm's length.
- IRS and foreign taxing authorities focus on transfer pricing to determine whether income is allocated appropriately to their jurisdiction.
- Regulations found at Reg. §1.482.
- Transaction-based and profit-based methods.
- Local File documents local country TP approach.
- Master File documents group's TP approach.

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Tax Planning for International Tax

- Identification
  - Identify issues and opportunities.
- Mitigation/Formulation
  - Determine alternative processes or structures that provide a more favorable result.
- Implementation
  - Put the plan into action!

Tax Planning for International Tax

Issue or Opportunity

- High volume of profitable exports (opportunity).
- Profitable foreign subsidiary with low net basis in tangible property (risk).
- Overlooked foreign reporting (risk).

Potential Solution

- FDII deduction or IC-DISC.
- Structuring or tax elections to reduce GILTI.
- Streamlined or delinquent procedures to catch up reporting.

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A slide so nice, I used it twice

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